



June 2013

DEFENSE CONTRACTORS

Information on the Impact of Reducing the Cap on Employee Compensation Costs

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GAO Highlights

Highlights of [GAO-13-566](#), a report to congressional committees

Why GAO Did This Study

Since the 1990s, federal law has placed a limitation, or cap, on the amount of employee compensation that contractors can charge to federal contracts. The cap increased by 63 percent in real terms since first use of the current approach in 1998. The cap was set at \$693,951 in 2010 and \$763,029 for 2011 and 2012.

The National Defense Authorization Act for Fiscal Year 2013 directed GAO to provide information on the effect of reducing the cap to the salary of the U.S. President or Vice President. GAO identified, among other things, (1) estimates of the number of employees of a sample of DOD contractors whose compensation would have exceeded a cap set at the salaries of either the U.S. President or Vice President and the amount of compensation that would not have been allowable and (2) the views of government and contractor representatives on potential effects of a reduction in the cap. GAO collected data from a nongeneralizable, stratified random sample of 10 large-tier, 10 mid-tier, and 10 small-tier contractors; reviewed relevant laws and regulations, and interviewed government and contractor representatives. Data on the number of employees affected by the cap was received from 27 of the 30 contractors; the three largest contractors in GAO's sample did not provide these data.

GAO is not making any recommendations in this report. DOD and OMB commented on a draft, noting the need to pay reasonable compensation costs. DOD also cited the need for more research given GAO's sample size. GAO believes this analysis provides valuable insights into potential effects of cap changes.

View [GAO-13-566](#). For more information, contact Timothy J. DiNapoli at (202) 512-4841 or dinapoli@gao.gov.

June 2013

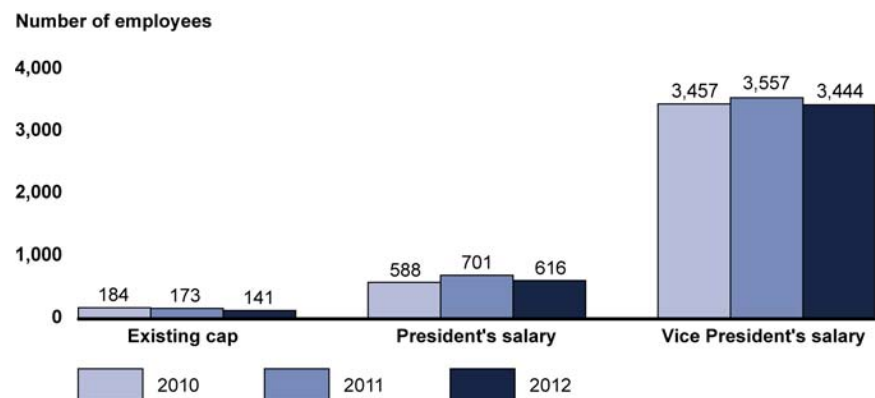
DEFENSE CONTRACTORS

Information on the Impact of Reducing the Cap on Employee Compensation Costs

What GAO Found

Reducing the cap to the President's salary (\$400,000) or the Vice President's salary (\$230,700) would have substantially increased the number of employees with compensation costs exceeding the cap in 2010-2012 (see figure).

Estimated Number of Employees with Compensation Costs in Excess of Each Cap Level for 27 of the 30 Contractors Sampled Who Provided Data



Source: GAO analysis of contractor-supplied data.

For 2010-2012, contractors identified over \$180 million per year in compensation costs that would have exceeded a cap set at the President's salary, and at least \$440 million per year if set at the Vice President's salary. Most affected employees were at large-tier companies; few small-tier companies had employees exceeding these caps. While employees with compensation costs in excess of the existing cap were all identified as executives by the contractors, reducing the cap would have increasingly affected compensation costs for individuals below the executive level.

Government representatives generally supported reducing the cap as a means to reduce the costs of Department of Defense (DOD) contracts, whereas industry representatives and most contractors identified negative effects that could result from reducing the cap. The Office of Management and Budget noted the growth in the cap has outpaced inflation and the rate of growth of federal salaries. DOD noted that it fully supported the principle of paying only reasonable compensation costs and some DOD officials supported reducing the cap, though DOD cautioned that there are limited data on the potential impacts of doing so and that the impact on the defense industry would need to be carefully monitored and assessed. Industry associations and contractors representatives noted that the compensation they offer to their employees is generally based on market surveys of compensation paid by private sector companies. While acknowledging that a reduced cap would not preclude them from compensating their employees above the cap, contractor representatives noted that doing so would come at the expense of company profits, which in turn may result in challenges in attracting capital from the financial markets. They also noted that reducing the cap may affect companies' ability to attract and retain top talent and, over the long term, lead companies to reassess their business and staffing models and potentially shift work or personnel from government business to their commercial sector.

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Abbreviations

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| DCAA | Defense Contract Audit Agency |
| DCMA | Defense Contract Management Agency |
| DPAP | Defense Procurement and Acquisition Policy |
| DOD | Department of Defense |
| FAR | Federal Acquisition Regulation |
| NASA | National Aeronautics and Space Administration |
| OMB | Office of Management and Budget |

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June 19, 2013

The Honorable Carl Levin
Chairman
The Honorable James Inhofe
Ranking Member
Committee on Armed Services
United States Senate

The Honorable Howard P. "Buck" McKeon
Chairman
The Honorable Adam Smith
Ranking Member
Committee on Armed Services
House of Representatives

Since the 1990s, federal law has placed a limitation, or cap, on the amount of contractor employees' compensation costs that is allowed to be charged on federal government contracts. Compensation costs can include many elements, such as salary, bonuses, stock options, and employer contributions to pension plans, although under federal law and the Federal Acquisition Regulation (FAR), contractors are only allowed to charge some elements of compensation to federal government contracts. The Administrator for Federal Procurement Policy within the Office of Management and Budget (OMB) is responsible for determining the cap, which is calculated based on an analysis of the compensation of senior executives at large, publicly traded companies. This cap, currently set at \$763,029, has increased in real terms by 63 percent since this approach was first used in 1998. The cap had only applied to certain senior contractor executives, but in 2012, legislation expanded the cap's applicability to all contractor employees performing under contracts awarded by the Department of Defense (DOD), the Coast Guard, and the

National Aeronautics and Space Administration (NASA).¹ This same legislation permits the Secretary of Defense to establish narrowly targeted exceptions to the cap for scientists and engineers, as needed.

Section 864 of the National Defense Authorization Act for Fiscal Year 2013 directed GAO to report to Congress on the effect of reducing the allowable costs of compensation to the salary of the U.S. President or that of the U.S. Vice President, which are currently \$400,000 and \$230,700, respectively.² This report provides (1) estimates of the number of employees of a sample of DOD contractors whose compensation would have exceeded a cap set at the salaries of either the U.S. President or Vice President, and the amount of compensation that would not have been allowable; (2) the status of DOD's efforts to establish an exception for scientists and engineers and the extent to which scientists and engineers would be affected by reducing the cap; and (3) the views of government and contractor representatives on potential effects of a reduction in the cap. In addition, in response to a matter identified in Section 864 of the National Defense Authorization Act of 2013, appendix II includes information on the extent to which employees of DOD contractors included in this review received compensation in the form of vested or unvested stock options.³

To assess these objectives, we reviewed relevant laws, regulations, and guidance, and interviewed representatives from Defense Procurement and Acquisition Policy (DPAP), the Office of the Assistant Secretary of Defense for Research and Engineering, the Defense Contract Audit Agency (DCAA), the Defense Contract Management Agency (DCMA), OMB, selected contractors, and industry associations with knowledge of contractor compensation issues. We requested data from a stratified, random sample of 30 contractors that had received fiscal year 2012 obligations in excess of \$1 million on DOD contracts for non-commercial

¹National Defense Authorization Act for Fiscal Year 2012, Pub. L. No. 112-81, § 803(a)(1) (2011). The expansion of the cap to all contractor employees does not apply to contracts awarded by other federal agencies.

²Pub. L. No. 112-239, § 864.

³A stock option typically has a vesting requirement, meaning that the employee may exercise the stock option only after a specified period of time has passed. If an employee's employment at a company terminates before the stock option has vested, the employee typically forfeits the unvested stock option upon termination.

items. Because the cap is concerned with cost-based contracts, we excluded commercial item contracts, as well as contractors that only had obligations on firm fixed price contracts and/or fixed-price with economic price adjustment contracts. We based our selection of contractors on data from USAspending.gov.⁴ We selected contractors from four strata based primarily on fiscal year 2012 contract obligations: (1) contractors with obligations greater than \$25 billion (2 contractors selected); (2) contractors with obligations between \$2 billion and \$25 billion (8 contractors selected); (3) contractors with obligations between \$15 million and \$2 billion (10 contractors selected); and (4) contractors with obligations between \$1 million and \$15 million (10 contractors selected). This sample is not generalizable, but is designed to illustrate the potential impact that reducing the cap would have on contractors of varying sizes. For the purposes of this report, we refer to contractors from the first two selection groups as large-tier contractors, the third group as mid-tier contractors, and the fourth group as small-tier contractors. The 30 contractors received about 25 percent of all fiscal year 2012 DOD contract obligations.

We requested data on a number of items, including the estimated number of employees with compensation costs that would have been allowable but for the cap and exceeded the contractor fiscal year 2010 cap of \$693,951; the fiscal year 2011 cap of \$763,029; and, for fiscal year 2012, the amount of \$763,029.⁵ Other information we requested from contractors included data on the estimated number of employees whose compensation would have exceeded the cap had it been set at the salaries of the President and Vice President in fiscal years 2010-2012, the estimated number of contractor employees performing under government contracts who were granted stock options or restricted stock, and the potential effects of reducing the cap. In our data request, we asked for data on most questions for fiscal years 2010, 2011, and 2012.

⁴USAspending.gov is a free, publicly accessible website established by the Office of Management and Budget containing data on federal awards (e.g., contracts, loans, and grants) across the government. The Federal Procurement Data System-Next Generation, the primary government-wide contracting database, is one of the main data sources for this website.

⁵The cap of \$763,029 is for fiscal year 2011 and subsequent contractor fiscal years, unless and until revised by the Office of Federal Procurement Policy. At the time of this review it had not published a revised cap amount for 2012. Therefore, for the purposes of this review, we used the 2011 cap for analysis of 2012 data.

To simplify the data request, we collected for fiscal year 2011 information on some questions where we determined one year of information was sufficient to provide useful insights, such as questions related to the number of employees at different management levels and a question about employee job titles. In these instances, we chose fiscal year 2011 rather than fiscal year 2012 to ensure that contractors would have the information available at the time of our request.

While we did not independently verify the contractor-reported data, we did take a number of steps to assess the reliability of the data. Specifically, we reviewed written responses provided by the contractors on the source of the data, when that data source was last reviewed or audited, steps taken by the contractor to ensure the accuracy and completeness of the data provided, critical assumptions made, and any known limitations on the reported data. We also looked for inconsistencies in the data, and followed up as necessary to resolve these inconsistencies. From these efforts, we believe the information is sufficiently reliable for the purposes of this report. Appendix I provides additional details on our scope and methodology.

We conducted this performance audit from January 2013 to June 2013 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives, with one limitation. We received complete responses to our data request from 27 of the 30 contractors in our sample—7 large-tier, 10 mid-tier, and 10 small-tier. The three largest contractors from which we requested data—The Boeing Company, Lockheed Martin Corporation, and Northrop Grumman Corporation—provided responses to our questions regarding company size, revenue, compensation practices and the potential impact of reducing the cap to the salaries of the U.S. President or Vice President. However, these contractors did not provide data on the number of employees with compensation costs greater than the salaries of the U.S. President or Vice President or on the estimated amount of total compensation that would no longer be allowable at these cap levels. These three contractors collectively accounted for about 18 percent of all DOD obligations in fiscal year 2012. Without the data from these three contractors, our findings with regard to the first objective do not fully reflect the impact on the large-tier contractors. For the purposes of this report, data presented on our entire sample reflect responses of the 27

contractors that provided us with complete data; these contractors accounted for 7 percent of DOD's contract obligations in fiscal year 2012. Of the 27, data on large-tier contractors reflects responses from 7 contractors.

Background

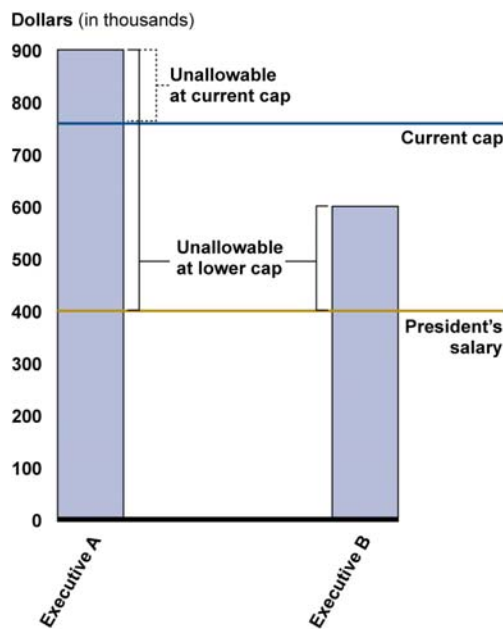
In fiscal year 2012, DOD obligated approximately \$360 billion on contracts for goods and services, such as major weapon systems, information technology, professional and administrative support, weapon system and base maintenance, and office supplies. DOD contracts with companies of varying size, structure, and type of business. For example, in terms of size, in 2012, the total number of U.S.-based employees at the 30 companies selected for this review ranged between 10 and more than 150,000. Some of these companies provide goods and services primarily to DOD, and some also provide goods and services to other federal agencies or the private sector. For example, the percentage of total revenues received from the government in 2012 among the companies included in this review ranged between 4 percent and 100 percent, with 24 of the 30 contractors reporting at least half of their revenues were received from the federal government.

Contractors can allocate and charge a number of costs to federal government contracts, including certain types and levels of compensation costs. The FAR identifies many elements of compensation, including salaries and wages, bonus and incentive compensation, pension costs, and fringe benefits such as sick leave, holidays, and employee insurance. Some compensation costs are considered allowable under government contracts, while others are considered unallowable. For example, compensation in the form of bonuses and incentives are allowable under certain conditions, such as that the basis for the award for a bonus or incentive payment is supported. Similarly, according to a DCAA official, in most cases, restricted stock (a form of long-term incentive that includes actual shares that are earned by continued employment with a company) is allowable, because the expense is fixed at the time the restricted stock is awarded. On the other hand, compensation calculated or valued based on changes in the prices of corporate securities or corporate security ownership, such as stock options, is unallowable.

In addition to certain types of compensation costs being unallowable, the cap set by the Office of Federal Procurement Policy can also limit the amount of compensation paid to certain contractor employees that can be charged to federal contracts. For purposes of the cap, the FAR defines compensation to include the total amount of wages, salary, bonuses,

deferred compensation, and employer contributions to defined contribution pension plans, for the fiscal year, whether paid, earned, or otherwise accruing, as recorded in the contractor's cost accounting records for the fiscal year. Because of the cap, there are compensation costs that might be otherwise allowable, but are unallowable because they exceed the cap. Figure 1 illustrates the impact of varying the cap on the allowable costs of compensation paid to two different executives for a company for which the only source of revenue was federal government contracts.

Figure 1: Hypothetical Example of the Effect of the Compensation Cap on Two Executives



Source: GAO analysis of compensation laws, regulation, and guidance.

In this hypothetical example, executive A was compensated a total of \$900,000 in fiscal year 2011. However, since the cap limited allowable compensation costs to \$763,029 in 2011, executive A's compensation included \$136,971 that was not allowable because it exceeded the cap. Executive B's compensation was \$600,000. Because \$600,000 was below the level of the cap, executive B's compensation was not subject to the cap. However, if the cap had been reduced to the salary of the President (\$400,000), then both executive A and executive B would have received compensation that would be unallowable because of the

reduced cap. While the cap limits the compensation costs that contractors can charge to government contracts, it does not limit what a company can compensate an employee.

To be allowable, the FAR requires that compensation costs be reasonable.⁶ In determining reasonableness, contracting officers can consider the extent to which an employee's compensation is consistent with other companies that are similar in size, industry, geographic area, and/or other factors. It is possible that compensation costs may be lower than the cap, but not reasonable. For example, in the hypothetical example provided in figure 1, some of Executive A's compensation costs beneath the \$763,029 cap may not be considered reasonable, if, for example, employees performing similar work and in companies with similar characteristics are compensated at a much lower level.

As a part of its auditing responsibilities, DCAA may audit compensation costs for allowability, allocability, and reasonableness. DCAA policy is that compensation in total is considered reasonable if the contractor's compensation is within a 10 percent range of the market level of compensation based on survey data.⁷ When compensation costs at a contractor are significant, auditors can request assistance from a specialized compensation team within DCAA, which follows a defined process for evaluating the reasonableness of executive compensation. This specialized team within DCAA also supports the Office of Federal Procurement Policy in developing the cap.

History of the Cap on Contractor Employee Compensation Costs

Since 1998, the Administrator for Federal Procurement Policy has determined the cap on allowable compensation costs.⁸ The cap is set at the median amount of the compensation provided for the five most highly compensated employees of all publicly owned U.S. corporations with

⁶FAR § 31.201-2(a)(1).

⁷In many cases the market level of compensation is based on weighted average (or median) levels of compensation as reported in surveys. However, according to DCAA officials, DCAA may establish the market level of compensation at a level between the 25th and 75th percentile compensation survey amounts based on overall contractor financial performance as indicated by a comparison to peer companies.

⁸The Administrator determines the cap in consultation with the Director of DCAA and other officials of executive agencies as the Administrator considers appropriate. 41 U.S.C. § 1127(b).

annual sales in excess of \$50 million for the most recent fiscal year for which data are available at the time of the determination. To help calculate the cap, DCAA contracts with an outside vendor, which collects and analyzes data submitted by corporations as part of the corporations' annual filing to the Securities and Exchange Commission. DCAA officials stated the analysis includes data from more than 3,000 companies. DCAA reviews the data provided by the vendor, then recommends the cap level to the Office of Federal Procurement Policy, which publishes the cap in the Federal Register.

Until recently, the cap on compensation costs has only applied to the five most highly compensated employees in management positions at each home office and each segment of a contractor. However, the National Defense Authorization Act for Fiscal Year 2012 expanded the applicability of the limitation to all contractor employees performing under contracts awarded by DOD, the Coast Guard, and NASA.⁹ The act also provided that the Secretary of Defense may establish narrowly targeted exceptions for scientists and engineers, if it is determined that such an exception is needed to ensure DOD has continued access to needed skills and capabilities.¹⁰

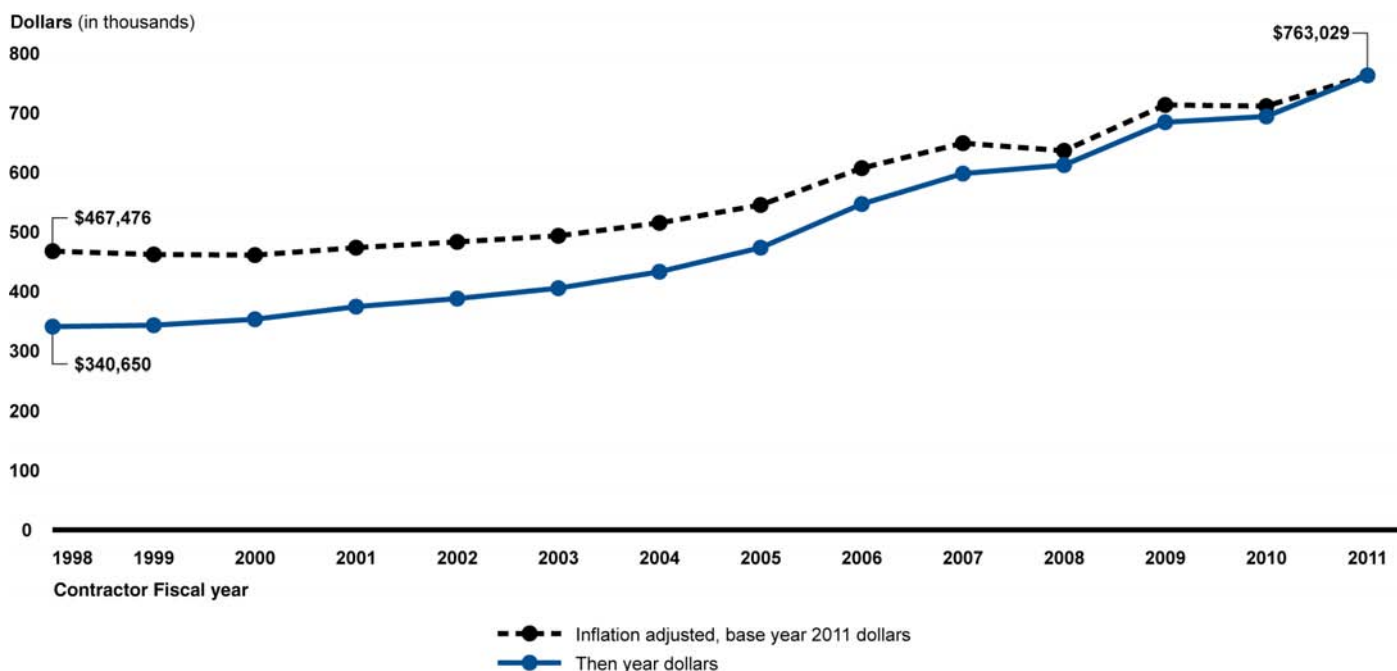
The current cap was set at \$763,029 and was published by the Office of Federal Procurement Policy on April 23, 2012. The \$763,029 cap applies to costs incurred during the contractors' fiscal year 2011 and to subsequent contractor fiscal years, unless and until revised by the Office of Federal Procurement Policy. The cap has more than doubled since 1998 in then-year dollars; when adjusted for inflation and measured in 2011 dollars, the cap has increased by about 63 percent in real terms. Figure 2 shows how the cap has changed since the benchmarking formula was first established.¹¹

⁹Pub. L. No. 112-81, § 803(a)(1) (2011).

¹⁰Pub. L. No. 112-81, § 803(a)(2) (2011).

¹¹Prior to the establishment of the benchmark formula, Congress limited by periodic legislation the amounts that could be charged to the government for an individual contractor employee's compensation on certain contracts. Appropriations Acts limited compensation on certain DOD contracts to \$250,000 in 1995, \$200,000 in 1996, and \$250,000 in 1997. Department of Defense Appropriations Act, 1995, Pub. L. No. 103-335, § 8117 (1994); Department of Defense Appropriations Act, 1996, Pub. L. No. 104-61, § 8086 (1995); Omnibus Consolidated Appropriations Act, 1997, Pub. L. No. 104-208, § 8071 (1996).

Figure 2: Change in the Compensation Cap from 1998 through 2011



Source: GAO analysis of Federal Register notices.

Number of Contractor Employees with Compensation Costs in Excess of Reduced Caps

Reducing the cap to the salaries of the U.S. President or Vice President would have substantially increased the number of employees with compensation above the cap in 2010-2012, and in turn, increased the amount of compensation costs that would have no longer been allowable under federal contracts.¹² Across the 27 contractors reviewed, fewer than 200 employees in any one year had compensation costs over the existing cap, but this number would have increased to more than 500 if the cap had been set at the President's salary, and to more than 3,000 if the cap had been set at the Vice President's salary. At each cap level, most of

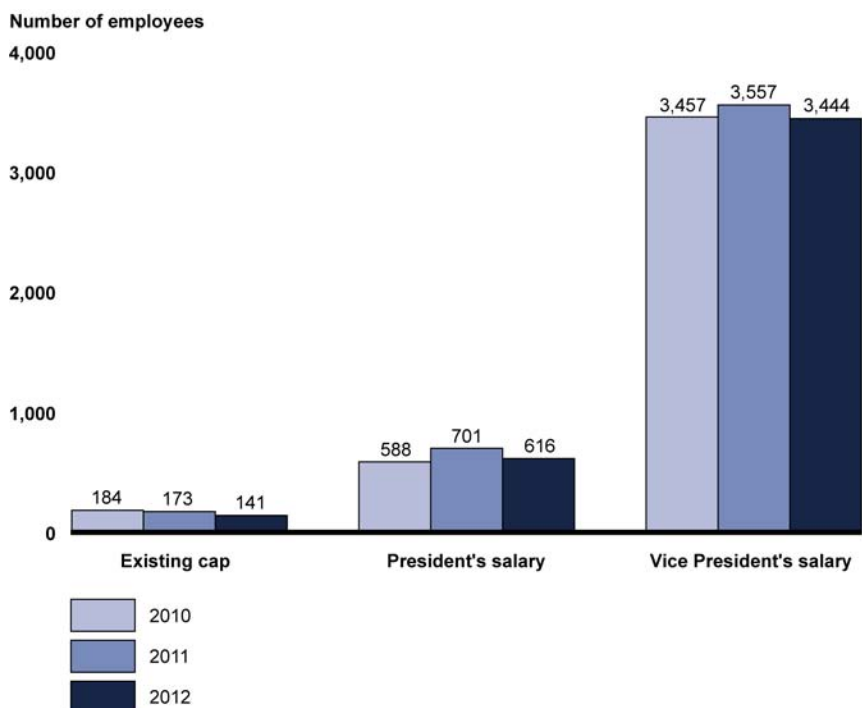
¹²While contractors in their responses generally excluded compensation cost data for parts of their businesses that performed very little or no work on U.S. government contracts, in some cases they did not isolate costs that were allocated to U.S. government contracts for employees in parts of their businesses that performed a mix of work. As a result, it is possible that some portion of compensation costs reflected in this report may not have been allocated to U.S. government contracts.

these employees were reported at the large-tier contractors; very few were at small-tier contractors. All of the employees with compensation costs in excess of the existing cap were identified as executives. However, reducing the cap would have increasingly affected individuals who were identified as being managers below the executive level, and in some cases, would have included individuals serving in non-management positions. With regard to compensation costs that would not have been allowable at the various cap levels in 2010-2012, the 27 contractors reported over \$80 million per year in estimated compensation costs in excess of the existing cap level. Were the cap set at the President's salary, this number would have risen to over \$180 million, and at the Vice President's salary, to at least \$440 million per year. The majority of costs in excess of each cap was reported at the large-tier contractors.

Estimated Number of Contractor Employees with Compensation Costs Subject to a Reduced Cap

Based on our analysis of data from the 27 contractors that provided detailed information, reducing the cap would have significantly increased the number of employees whose compensation exceeded the cap (see figure 3).

Figure 3: Estimated Number of Employees with Compensation Costs in Excess of Each Cap Level (for 27 of the 30 Contractors Sampled That Provided Data)

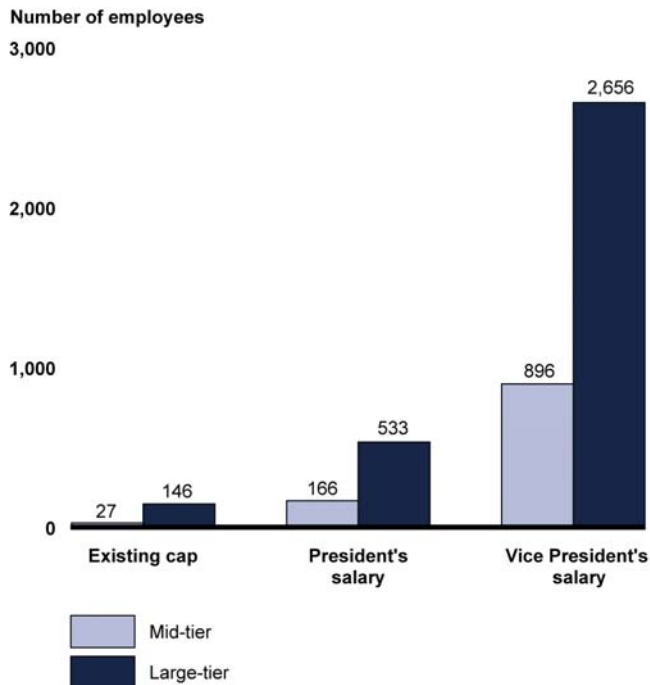


Source: GAO analysis of contractor-supplied data.

For example, our analysis indicates that over the last three years, the contractors reported that in total less than 200 employees each year had compensation costs that exceeded the existing cap level; however, they reported more than 500 employees each year with compensation costs that exceeded the President's salary, and over 3,000 employees each year had compensation costs that exceeded the Vice President's salary.

Figure 4 shows that most employees with compensation exceeding the various cap levels were employed at large-tier contractors.

Figure 4: Estimated Number of Employees with Compensation Costs in Excess of Each Cap Level in 2011 for 7 Large-Tier and 10 Mid-Tier Contractors Reviewed



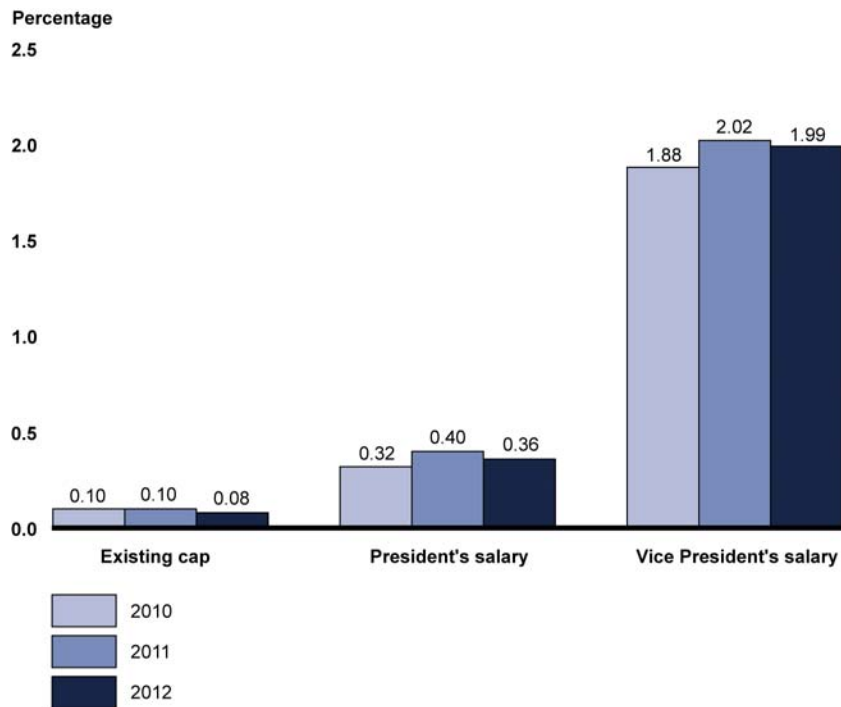
Source: GAO analysis of contractor-supplied data.

Note: Figure does not include responses from the 10 small-tier contractors we reviewed. Only three of these contractors had employees with compensation costs that exceeded the President's or Vice President's salary.

As illustrated in figure 4, the seven large-tier contractors reported approximately three times as many employees with compensation costs that exceeded the President's and Vice President's salaries as did the 10 mid-tier contractors, and more than five times as many employees with compensation costs that exceeded the existing cap. Small-tier contractors reported very few employees above any of the cap levels—with only 3 of the 10 small-tier contractors reporting an employee above any of the cap levels. In total, the 10 small-tier contractors we reviewed reported no employees in any year with compensation costs that exceeded the existing cap level, no more than two employees in any year with compensation costs above the President's salary, and no more than five employees in any year above the Vice President's salary.

Collectively, the 27 contractors reported that employees whose compensation exceeded the various caps represented 2 percent or less of their total number of employees who had costs allocable to government contracts (see figure 5).

Figure 5: Estimated Percentage of Employees with Costs Allocated to U.S. Government Contracts Whose Compensation Costs Exceeded Each Cap Level (for 27 of the 30 Contractors Sampled That Provided Data)



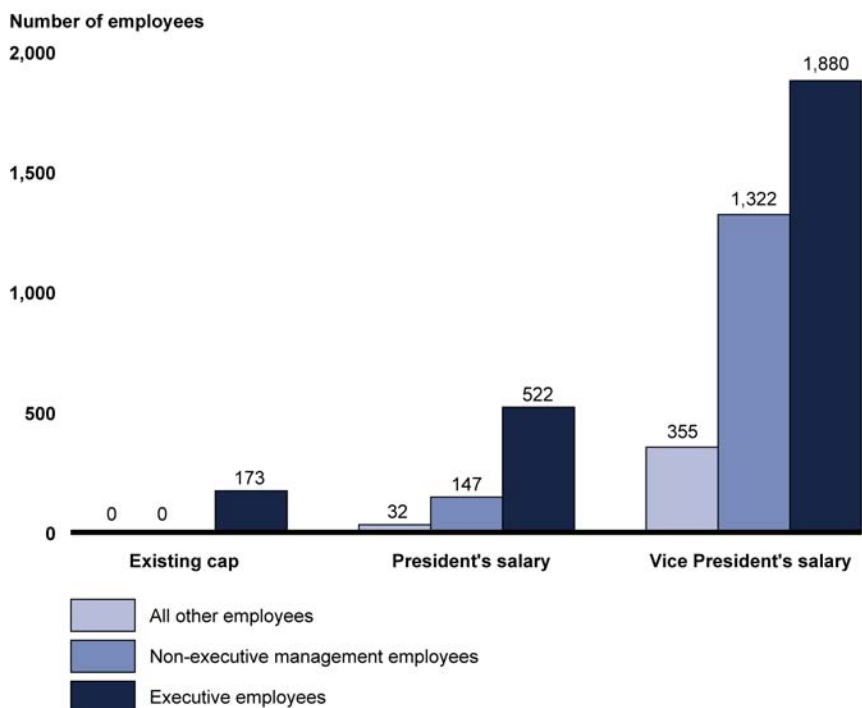
Source: GAO analysis of contractor-supplied data.

The proportion of employees with compensation costs affected by the different cap levels would generally have been greater at the 7 large-tier contractors than the 10 mid-tier contractors reviewed. For example, in 2011, at the 7 large-tier contractors, an estimated 2.4 percent of employees had compensation costs that would have exceeded the salary of the U.S. Vice President, whereas at the 10 mid-tier contractors, 1.4 percent would have exceeded the salary of the Vice President.

Almost Half the Employees Affected by Reducing the Cap to the Vice President's Salary Would Not Have Been Considered Executives

Figure 6 illustrates the number of contractor employees at different management levels with compensation costs in excess of each cap for 2011. Contractors included in this review categorized employees as either executives, non-executive managers, or other, non-management employees.

Figure 6: Estimated Number of Employees by Management Level with Compensation Costs in Excess of Cap Levels in 2011 (for 27 of the 30 Contractors Sampled That Provided Data)



Source: GAO analysis of contractor-supplied data.

Note: Classification of employees at each management level was determined by the contractors reviewed.

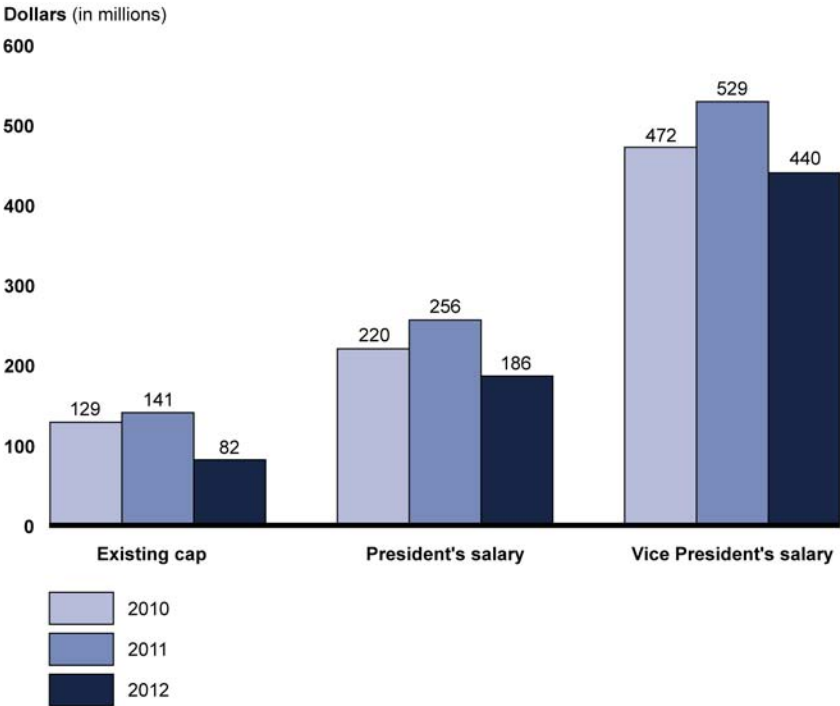
All employees with compensation costs that exceeded the existing cap were identified as executives. Many of those above the existing cap were identified by their job title as corporate officers or executive vice presidents. As the cap is reduced, however, employees in non-executive management positions, or in some cases, those who would not be considered managers, were increasingly affected. For example, contractors reported that reducing the cap to the President's salary would mean that 147 employees that they considered management, but not executives, would have been affected, as well as 32 non-management

employees. At this cap level, many employees were identified as senior vice presidents and vice presidents. At the Vice President's salary, over one-third of the affected employees would have been considered non-executive management personnel, and approximately 10 percent would have been employees who contractors would not consider to be serving in a management position. Employees whose compensation exceeded the Vice President's salary included program managers and directors, as well as others, such as systems engineers or intelligence analysts.

Amount of Compensation
Cost Potentially Affected
by a Reduced Cap

As the number of employees that would have been affected by reducing the existing cap increases, so too does the amount of compensation that would have no longer been allowable under government contracts. As illustrated in figure 7, the 27 contractors reported, in total, over \$80 million in each year in estimated compensation costs that exceeded the existing cap level.

Figure 7: Estimated Compensation Costs in Excess of Each Cap Level (for 27 of the 30 Contractors Sampled That Provided Data)



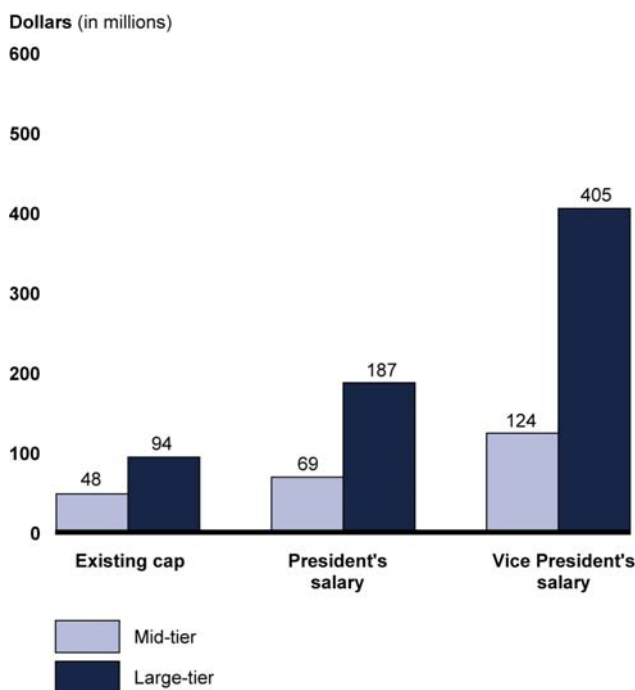
Source: GAO analysis of contractor-supplied data.

Note: The five most highly compensated employees in management positions at each contractor home office and segment accounted for approximately \$67 million of the 2010 costs shown in the figure, \$91 million of the 2011 costs, and \$59 million of the 2012 costs.

Contractors identified over \$180 million per year in compensation costs that would have exceeded a cap set at the President's salary, and at least \$440 million per year if set at the Vice President's salary.

Large-tier contractors reported greater amounts of compensation costs that exceeded each of the cap levels than did mid-tier contractors, as shown in figure 8.

Figure 8: Estimated Compensation Costs in Excess of Each Cap Level in 2011 for 7 Large-Tier and 10 Mid-Tier Contractors Reviewed



Source: GAO analysis of contractor-supplied data.

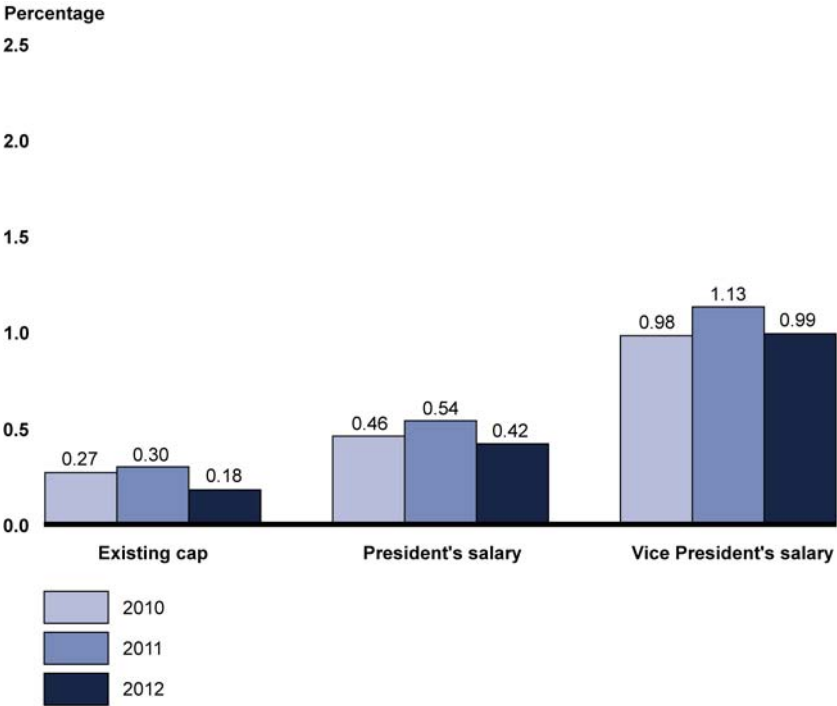
Note: Figure does not include responses from the 10 small-tier contractors we reviewed. Only 3 of these contractors had employees with compensation costs that exceeded the President's or Vice President's salary.

As figure 8 illustrates, in 2011, the 7 large-tier contractors reported approximately twice as much compensation cost that exceeded the existing cap level than did the 10 mid-tier contractors. The large-tier contractors also reported more than three times as much compensation

cost that exceeded the Vice President’s salary than did the mid-tier contractors, and more than twice as much compensation cost that exceeded the President’s salary. Small-tier contractors reported very small amounts of compensation cost above any of the cap levels.

Overall, across all 27 contractors, reported compensation costs in excess of any of the cap levels represented approximately 1 percent or less of the contractors’ total revenues from the U.S. government, as shown in figure 9.

Figure 9: Estimated Percentage of Total Revenues from the U.S. Government Represented by Compensation Costs That Exceeded Each Cap Level (for 27 of the 30 Contractors Sampled That Provided Data)



Source: GAO analysis of contractor-supplied data.

We found that compensation costs in excess of the existing cap were slightly higher as a percentage of revenues from the government for the 10 mid-tier contractors than the 7 large-tier contractors, and slightly lower at the other two cap levels.

DOD Has Not Created an Exception for Scientists and Engineers but the Impact Is Minimal at the Current Cap Level

DOD has not established an exception for scientists and engineers as permitted under recent legislation and has no ongoing efforts to do so. DOD officials noted that few, if any, individuals whose compensation exceeds the current cap level are serving as a scientist or an engineer. DOD officials noted that if the cap were to be reduced, then it would consider the need for an exception for scientists and engineers at that point. While the ability to create exceptions had support from industry, contractor and industry association representatives identified a number of challenges that DOD could face in creating an exception for scientists and engineers. Both DOD and contractors expressed the need for an ability to create additional exceptions should the need arise.

DOD Has Not Created an Exception for Scientists and Engineers

The 2012 legislation expanding the cap on contractor compensation costs to all contractor employees also allowed the Secretary of Defense to establish narrowly defined exceptions for scientists and engineers to ensure that the DOD has access to critical skills and capabilities.¹³ As of April 2013, DOD had not established such an exception, and according to DPAP officials, there are no ongoing efforts to do so. DPAP officials explained that at the current cap of \$763,029, few, if any, individuals whose total compensation exceeds that cap are serving as a scientist or engineer. DPAP officials also noted they believed this would continue to be the case even after DOD issues regulations to implement the 2012 legislation to expand the cap to cover all contractor employees working under contracts awarded by DOD, the Coast Guard, and NASA.¹⁴

Were the cap to be reduced, however, DPAP officials noted that they would need to consider whether to establish an exception because the compensation of more individuals would be covered by the cap. DPAP officials told us that while no formal planning process is underway, among the options they could consider would be to approve an exception on a case-by-case basis based on a request from a contractor or from within DOD, or potentially on a broader class basis for scientists or engineers

¹³Pub. L. No. 112-81, § 803(a)(2) (2011).

¹⁴The legislation required DOD to implement regulations within 180 days after enactment. DOD officials noted that DOD submitted two cases to the Federal Acquisition Regulatory Council to extend the compensation cap to all DOD, NASA, and Coast Guard employees in 2012. Pub. L. No. 112-81, § 803(c)(1). As of April 2013, these cases were still being reviewed by the Office of Information and Regulatory Affairs, which is charged with reviewing proposed changes in federal regulations.

that possess critical skill sets that are not widely available in the private sector. DPAP officials noted that these could include nuclear engineers with experience in designing propulsion systems or engineers with experience in space launch technologies. A senior official from DOD's Office of the Assistant Secretary of Defense for Research and Engineering identified others, such as industrial engineers with cost estimating experience, who might merit consideration, especially if the economy improves. DOD officials also told us that in order for contractor employees to qualify for an exception, they would need to function as a scientist or engineer rather than be identified as such solely based on background or education.

Contractor Perspectives on Challenges in Creating Exceptions

While the ability to create exceptions had support from industry, contractors and industry groups noted that a key challenge in developing any exception would be how to identify and verify those who would qualify. For example, industry representatives told us that there might be added administrative requirements on the government and the industry to verify how particular employees spend their time in order to qualify for an exception. One contractor explained that using job titles to identify scientists and engineers would not be meaningful since it may or may not reflect an employee's functional status as a scientist or engineer. In that regard, in our analysis of the data provided by contractors, we found that the number of scientists and engineers identified by the contractors was not always consistent with the number of contractor employees with "engineer" or "scientist" in their job title. For example, one contractor classified a total of 10 employees as scientists or engineers that would be affected by the various cap levels, but listed 33 employees over the cap with the word "engineer" or "scientist" in their job title. Another contractor listed 126 employees with compensation costs over the salary of the Vice President that had the word "scientist" or "engineer" in their job title, but chose not to classify any of these individuals as scientists or engineers, as they considered these scientists and engineers to be executives.

Similarly, industry representatives noted that if the exception were to be based on whether or not the individual performed a scientific or engineering function, then scientists and engineers that are promoted into supervisory or managerial positions may not qualify. Industry representatives noted these individuals often play critical functions in executing DOD programs, but may not necessarily be performing engineering or scientific tasks. For example, based on the data provided by the contractors for fiscal year 2011, if the cap were reduced to the salary of the Vice President, the majority of the scientists and engineers

that would have been affected were classified as serving in non-executive management positions. Industry representatives also noted that there is a growing trend to train employees to be able to perform multiple tasks and wondered how an exception would account for employees that spend their time performing engineering and/or financial tasks, supervising projects, and programming.

Both DOD and contractor representatives noted that the exception is limited to scientists and engineers, but there may be others providing valuable skills for the government and that these skills may change over time. DPAP officials noted that the legislation currently limits the ability to establish an exception to scientists and engineers and indicated that other specialties, such as surgeons in the medical profession, may also warrant an exception. These officials indicated that DOD would need to seek additional legislation if it determines a need to attract or retain such skills and capabilities. Similarly, contractor representatives noted they have employees who provide other types of critical skills to DOD, such as in the medical or cyber-security areas, and that these skills can shift over time. For example, they noted that previously there was a shortage of structural engineers which resulted in higher compensation levels for those employees, whereas currently software engineers are in high demand. Consequently, they suggested an ability to develop or modify exceptions to cover changing conditions would be beneficial.

Government and Contractor Views on the Potential Effects of a Reduced Cap Differed

Government and contractor representatives emphasized differing perspectives on the potential effects should the current cap be reduced to the salary of either the U.S. President or Vice President. Government representatives generally supported reducing the cap as a means to help reduce the costs of DOD contracts, whereas industry representatives and most contractors we reviewed emphasized potential negative impacts to reducing the cap.

Government Representatives Generally Supported Reducing the Cap

OMB and DOD representatives generally supported a reduced compensation cap. OMB noted that the growth in the cap has outpaced the rate of inflation, the rate of growth of private sector salaries generally, and the rate of growth of federal salaries. OMB believed a reduced cap could bring pay parity between the amount taxpayers pay for senior executives of the federal government and the amount it pays contractors to reimburse the costs of compensation for senior executives who perform work for the federal government on certain types of contracts. OMB noted that the cap does not and would not limit the amount a

contractor compensates its employees; rather it limits how much taxpayers reimburse the contractors. OMB staff also noted that they support the idea of an exception for scientists and engineers to alleviate situations where the government should pay more than the capped amount to obtain the necessary talent.

DOD noted that it fully supported the principle of paying only reasonable compensation costs and some DOD officials supported reducing the cap, though DOD cautioned that there are limited data on the potential impacts of doing so and that the impact on the defense industry would need to be carefully monitored and assessed. DPAP officials stated that industry would still be able to access necessary talent and noted that many positions within defense companies involve skills and capabilities readily available in the commercial marketplace. However, they also stated that there are certain specialties that are critical to achieving DOD's missions and that individuals in those specialties should be compensated appropriately. At the same time, DPAP officials stated that it is not DOD's role to determine how much contractor employees are compensated. In terms of the administrative impact of a reduced cap on contract audit and oversight processes, DCAA and DCMA officials stated that they would expect additional workload associated with a reduced cap. For example, if the cap were set at the salary of the Vice President, DCAA officials noted they would need to evaluate whether individuals working on a single contract might have compensation costs that exceeded the cap.

Industry Association and Contractor Views on Reducing the Cap

Industry associations and many contractors questioned the premise of capping allowable contractor compensation costs at a set amount which is not based on market competition, emphasizing that standard industry practice is to benchmark employee compensation levels based on compensation levels for similar positions at their competitors and other private sector companies. In addition, an industry association noted that the FAR states that a cost is considered reasonable if it does not exceed "that which would be incurred by a prudent person in the conduct of competitive business," and linked this statement to the defense industry practice of analyzing market trends in compensation.¹⁵

¹⁵FAR § 31.201-3(a).

According to industry representatives and contractor representatives, defense companies generally obtain market survey information to aid in determining the appropriate compensation levels for a range of positions, not just senior executives. For example, the defense industry competes for highly specialized engineers, software engineers, and manufacturing specialists that help design, test, and manufacture DOD weapon systems. Other company representatives noted that the defense industry also competes with global industries of all types for highly qualified management personnel, including finance specialists, program managers, and other functional experts. Market survey information forms the basis for offers companies make to prospective new hires as well as changes in compensation designed to retain existing employees at all levels within the company. To be competitive for talent and manage total personnel costs to the company, industry associations and contractor representatives reported that defense companies typically target compensation levels at the median amount offered in the market for a given position, and have established ranges above and below that level that can be used to address specific circumstances. In that regard, an industry association provided summary benchmarking information that indicated the competitive compensation ranges for a variety of disciplines and positions, including those in engineering, finance, general management, information technology, general counsel, and manufacturing and quality assurance, exceeded the salary of the Vice President, and in some cases, exceeded both the salary of the President and the current cap. Industry representatives noted that the definition of compensation used in the summary benchmarking information differs from the definition of compensation used for the cap. As a result, it is not possible to directly compare the summary benchmarking information provided to the potential new cap levels.

Additionally, industry associations and contractor representatives cited a number of long-term negative impacts or potential unintended consequences of reducing the cap. For example, several contractor and industry representatives stated that even though a cap does not limit what the company can pay the employee, companies may consider limiting the compensation paid to their employees over the long term. These representatives noted that industry relies on capital markets to provide the capital necessary to operate and invest in future capabilities. To attract capital, the markets demand that industry match its cost structure to what its customers, such as the government, are willing to pay. If large numbers of employees were paid in excess of what is allowable under government contracts, then the companies' cash flow would be disrupted and the potential to generate earnings would be reduced. In turn, this

condition would impair a company's access to capital markets, and damage shareholder value. To mitigate the risk posed by this scenario, these representatives noted that a company may reduce the compensation levels for employees to reduce or eliminate the gap between what is paid to the employee and what is reimbursed by the government.

Similarly, several contractors stated their view that companies' ability to attract and retain the most highly talented individuals may be reduced if the company limits their compensation, particularly once they become most valuable in terms of their skills and expertise. Some contractors further noted that if government contractors are unable to attract and retain top talent, this may result in a lower quality of products and services provided to the government. For example, one industry association representative stated that knowledgeable, practiced, and compensated talent can more efficiently and effectively address complex issues as opposed to less experienced talent.

More generally, companies also noted that reducing the cap might encourage companies to shift away from defense or other government contract work to commercial work. For companies with both commercial and government work, some company representatives stated that assigning the company's best talent to the commercial side of the business may become a more prudent business decision because of the ability to recover the total costs of an employee's compensation; contractor employees who have a choice may also opt not to work on government contracts to avoid potential constraints on compensation. They also stated their view that, if this were the case, then the government may not have access to the skills and capabilities needed to successfully produce or deliver high-quality, technologically advanced goods and services to DOD.

While industry associations and many of the large-tier and mid-tier contractors expressed concerns should the cap be reduced, most small-tier companies we reviewed generally stated they would either be only minimally affected or not affected should the cap be reduced because they generally did not offer compensation above the Vice President's salary.

Agency Comments and Our Evaluation

OMB's e-mailed response stated that the compensation amounts identified in the report underscore the need for action to reform the cap. OMB stated that it has sent a legislative proposal to Congress that would abolish the current formula for calculating the cap, tie the level of the cap instead to the President's salary, and apply it to all employees for both defense and civilian cost reimbursement contracts. OMB also stated that savings from lowering the cap would be substantially higher than the \$180 million cited in the report as compensation costs exceeding the President's salary, since the contractors included in the sample account for 7 percent of DOD's fiscal year 2012 contract obligations. OMB also provided technical comments, which were incorporated into the report as appropriate.

DOD provided written comments on a draft of this report. DOD stated that the report provides a significant amount of information, but expressed concern that it is based on a relatively small sample of DOD contractors and cited a need for additional research to determine what constitutes reasonable employee compensation costs. DOD also stated that, while it fully supports the principle of paying only reasonable compensation costs, it must avoid a policy that would drive away the talent needed to maintain strategic advantage and the national industrial base. DOD's comments are reprinted in appendix III.

We noted in the report that our sample was not generalizable and that some findings, particularly those associated with the impact that the potential reductions of the cap may have on the large-tier contractors, are limited since the three largest contractors selected did not provide requested data. Nevertheless, we believe the report provides valuable insights into the potential implications of changes in the cap. These insights include (1) how the cap levels would have affected selected large-tier, mid-tier, and small-tier contractors differently, both in terms of numbers of employees affected and the amount of compensation costs considered unallowable, and (2) how, as the cap is lowered, more employees in non-executive positions would have been affected at these contractors.

We are sending copies of this report to interested congressional committees, the Secretary of Defense; the Director of the Office of Management and Budget; and other interested parties. This report will also be available at no charge on GAO's website at <http://www.gao.gov>.

If you or your staff have any questions concerning this report, please contact me at (202) 512-4841 or by e-mail at dinapolit@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix IV.

A handwritten signature in black ink, appearing to read "Timothy J. DiNapoli". The signature is fluid and cursive, with the first name "Timothy" and last name "DiNapoli" clearly distinguishable.

Timothy J. DiNapoli
Director
Acquisition and Sourcing Management

Appendix I: Objectives, Scope, and Methodology

Section 864 of the National Defense Authorization Act for Fiscal Year 2013 directed GAO to report to Congress on the effect of reducing the allowable costs of compensation to the salary of the U.S. President or that of the U.S. Vice President, which are currently \$400,000 and \$230,700, respectively.¹ This report provides (1) estimates of the number of employees of a sample of Department of Defense (DOD) contractors whose compensation would have exceeded a cap set at the salaries of either the U.S. President or Vice President, and the amount of compensation that would not have been allowable; (2) the status of DOD's efforts to establish an exception for scientists and engineers and the extent to which scientists and engineers would be affected by reducing the cap; and (3) the views of government and contractor representatives on potential effects of a reduction in the cap. In addition, in response to a matter identified in Section 864 of the National Defense Authorization Act of 2013, appendix II includes information on the extent to which employees of DOD contractors included in this review received compensation in the form of vested or unvested stock options.²

To assess these objectives, we reviewed relevant laws (e.g., National Defense Authorization Act for Fiscal Year 2012 (Pub. L. No. 112-81, § 803(a)(1) (2011)), National Defense Authorization Act for Fiscal Year 1998 (Pub. L. No. 105-85, § 808(a)(1) (1997)), regulations (e.g., Federal Acquisition Regulation (FAR) Subpart 31.2—Contracts with Commercial Organizations), and guidance (e.g., Defense Contract Audit Agency (DCAA) Contract Audit Manual Chapter 6 (Incurred Costs Audit Procedures)) and interviewed representatives from Defense Procurement and Acquisition Policy, the Office of the Assistant Secretary of Defense for Research and Engineering, DCAA, the Defense Contract Management Agency, the Office of Federal Procurement Policy within the Office of Management and Budget, selected contractors, and industry associations with knowledge of contractor compensation issues, including the Aerospace Industries Association, Financial Executives International, Professional Services Council, and TechAmerica.

¹Pub. L. No. 112-239, § 864.

²A stock option typically has a vesting requirement, meaning that the employee may exercise the stock option only after a specified period of time has passed. If an employee's employment at a company terminates before the stock option has vested, the employee typically forfeits the unvested stock option upon termination.

We also requested data from a stratified, random sample of 30 contractors on a number of items related to each objective. Detailed information on how we selected the 30 contractors is included below. In our data request, we asked for data on most questions for fiscal years 2010, 2011, and 2012. To simplify the data request, we collected for fiscal year 2011 information on some questions where we determined one year of information was sufficient to provide useful insights, such as questions related to the number of employees at different management levels and a question about employee job titles. In these instances, we chose fiscal year 2011 rather than fiscal year 2012 to ensure that contractors would have the information available at the time of our request. While we did not independently verify the contractor reported data, we did take a number of steps to assess the reliability of the data. Specifically, we reviewed written responses provided by the contractors on the source of the data, when that data source was last reviewed or audited, steps taken by the contractor to ensure the accuracy and completeness of the data provided, critical assumptions made, and any known limitations on the reported data. We also looked for inconsistencies in the data, and followed up as necessary to resolve these inconsistencies. From these efforts, we believe the information is sufficiently reliable for the purposes of this report.

In addition to the tasks performed that were relevant to all objectives, we performed the following tasks specific to each objective:

- To determine the extent to which DOD contractors would be affected by reducing the cap to the salaries of the President and Vice President, we collected and analyzed data from selected contractors on the estimated number of employees with compensation costs that would have been allowable (as determined by the contractors) but for the cap and exceeded the contractor fiscal year 2010 cap of \$693,951; the fiscal year 2011 cap of \$763,029; and, for fiscal year 2012, the amount of \$763,029.³ We also collected data on the dollar amounts of compensation costs for these employees that would have been considered unallowable in 2010, 2011, and 2012 by virtue of exceeding either the current cap, the salary of the President, or that of

³The cap of \$763,029 is for fiscal year 2011 and subsequent contractor fiscal years, unless and until revised by the Office of Federal Procurement Policy. At the time of this review it had not published a revised cap amount for 2012. Therefore, for the purposes of this review, we used the 2011 cap for analysis of 2012 data.

the Vice President. To provide insight into the types of employees affected, we also collected information on the titles of the individuals who would have exceeded those three potential cap levels in contractor fiscal year 2011, as well as on whether the contractor would have classified affected employees as executives, non-executive management, or non-management.

- To determine the status of DOD's exception for scientists and engineers and the extent to which scientists and engineers would be affected by reducing the cap, we interviewed DOD officials on the status of and/or plans for establishing an exception and to whom such an exception might apply. We collected and analyzed data from selected contractors on the number of employees the contractor would have classified as scientists and engineers, based either on function, education, or background, and information on the proportion of these scientists and engineers considered executives, non-executive management, or non-management for contractor fiscal year 2011. We also interviewed other government representatives, industry associations, and selected contractors to identify the potential impact of reducing the cap on scientists and engineers and other highly skilled professionals.
- To determine government and contractor representatives' views on the potential impacts of reducing the cap, we interviewed government representatives and industry associations. We also analyzed qualitative responses obtained as a part of our data request from contractors selected for review on the potential impacts of reducing the cap.

To determine the extent to which contractor employees received compensation in the form of stock options, we reviewed regulations (e.g., FAR § 31.205-6(i)) and guidance (e.g., DCAA Contract Audit Manual 7-2123) governing the allowability of stock options and other stock related compensation. We collected and analyzed data from selected contractors on the number of contractor employees performing under government contracts who were granted stock options, and the number of contractor employees performing under government contracts who were granted restricted stock, for contractor fiscal years 2010, 2011, and 2012.

Contractor Selection Methodology

To obtain data for each of the objectives, we selected a stratified, random sample of 30 contractors that had received fiscal year 2012 obligations in excess of \$1 million on DOD contracts for non-commercial items. Because the cap is concerned with cost-based contracts, we excluded commercial item contracts, as well as contractors that only had obligations on firm fixed price contracts and/or fixed-price with economic

price adjustment contracts. We based our selection of contractors on data from USAspending.gov.⁴

We divided the contractors into four strata: contractors with fiscal year 2012 obligations (1) greater than \$25 billion; (2) between \$2 billion and \$25 billion; (3) between \$15 million and \$2 billion with primarily non-small business dollar obligations; and (4) between \$1 million and \$15 million with obligations that were primarily small business dollars. All contractors in the first stratum were selected (2 total). The 19 contractors in the second stratum were divided into those that primarily provided products and those that primarily provided services, and 4 contractors were randomly selected from each of those groups (8 total). Ten contractors were randomly selected from the third stratum, and another 10 contractors were randomly selected from the fourth stratum. For the purposes of this report, we refer to contractors from the first two selection groups as large-tier contractors, the third group as mid-tier contractors, and the fourth group as small-tier contractors. The 30 contractors received about 25 percent of all fiscal year 2012 DOD contract obligations. We randomized the full lists of contractors at each stratum before making the selection, anticipating that certain contractor characteristics not evident at the time of randomization may require exclusion from the sample. This approach allowed us to move to the next contractor on the list in cases where contractors did not meet criteria for selection, while still maintaining a random selection process. Reasons for exclusion included the contractor being a non-profit, imperfections in the data (e.g., the Department of Energy being listed as a company), or the contractor not being incorporated in the United States. This sample is not generalizable, but is designed to illustrate the potential impact that reducing the cap would have on contractors of varying sizes.

We conducted this performance audit from January 2013 to June 2013 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that

⁴USAspending.gov is a free, publicly accessible website established by the Office of Management and Budget containing data on federal awards (e.g., contracts, loans, and grants) across the government. The Federal Procurement Data System-Next Generation, the primary government-wide contracting database, is one of the main data sources for this website.

the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives, with one limitation. We received complete responses to our data request from 27 of the 30 contractors in our sample—seven large-tier, 10 mid-tier, and 10 small-tier. The three largest contractors from which we requested data—The Boeing Company, Lockheed Martin Corporation, and Northrop Grumman Corporation—provided responses to our questions regarding company size, revenue, compensation practices and the potential impact of reducing the cap to the salaries of the U.S. President or Vice President. However, these contractors did not provide data on the number of employees with compensation costs greater than the salaries of the U.S. President or Vice President or on the estimated amount of total compensation that would no longer be allowable at these cap levels. These three contractors collectively accounted for about 18 percent of all DOD obligations in fiscal year 2012. Without the data from these three contractors, our findings with regard to the first objective do not fully reflect the impact on the large-tier contractors. For the purposes of this report, data presented on our entire sample reflect responses of the 27 contractors that provided us with complete data; these contractors accounted for 7 percent of DOD's contract obligations in fiscal year 2012. Of the 27, data on large-tier contractors reflects responses from 7 contractors.

Appendix II: Grants of Stock Options or Restricted Stock to Contractor Employees

Across the large-tier and mid-tier contractors included in this review, seven reported their company granted stock options (vested or unvested) to employees with compensation costs allocated to U.S. government contracts in any of the years covered. These contractors granted stock options on average to between 0.6 percent and 0.9 percent of employees, depending on the year. Nine of the contractors reported granting restricted stock to employees. These contractors granted restricted stock on average to between 0.8 percent and 1.2 percent of employees, depending on the year. No small-tier contractor included in this review reported granting stock options or restricted stock to any employees during the years covered.

Appendix III: Comments from the Department of Defense



ACQUISITION,
TECHNOLOGY
AND LOGISTICS

THE UNDER SECRETARY OF DEFENSE

3010 DEFENSE PENTAGON
WASHINGTON, DC 20301-3010

JUN 10 2013

Mr. Timothy J. DiNapoli
Director
Acquisition and Sourcing Management
U.S. Government Accountability Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. DiNapoli:

Thank you for the opportunity to review the General Accountability Office (GAO) Draft Report, GAO-13-566, "Defense Contractors: Information on the Impact of Reducing the Cap on Employee Compensation Costs," dated May 2013 (GAO Code 121116).

This report provides a significant amount of information, but we question whether this study is sufficient to provide a reliable prediction of the impact of the proposed compensation cap to Government contracts – particularly among the wide variety of firms, both large and small, that provide supplies and services across the DoD Enterprise. We are also concerned that the data in the report may not be representative since the sample is relatively small (only 30 contractors in total) when we rely upon literally tens of thousands of suppliers. Moreover, in the small sample size, a significant number of the key primes did not provide their information.

The Department believes additional research is necessary to develop a well-founded, equitable approach to determine what constitutes reasonable employee compensation costs. Factors to be considered in such an analysis include the baseline or benchmark to be used, logic and relationship of that benchmark to the marketplace, the interchange of employees between Government and commercial work, as well as the actual amount of employee salary allocated to Government contracts. While the Department fully supports the principle of paying only reasonable compensation costs, we must avoid a policy that serves to drive away the very talent that we need to maintain our strategic advantage and national industrial base.

Thank you again for the opportunity to comment.

Sincerely,

A handwritten signature in black ink, which appears to read "Frank Kendall", is written over a printed name "Frank Kendall".

Frank Kendall

Appendix IV: GAO Contact and Staff Acknowledgments

GAO Contact

Timothy J. DiNapoli, (202) 512-4841 or dinapolit@gao.gov

Staff Acknowledgments

In addition to the contact named above Karen Zuckerstein (Assistant Director), Robert Bullock, Virginia Chanley, John Crawford, Danielle Greene, Julia Kennon, John Krump, Janet McKelvey, and Roxanna Sun made key contributions to this report.

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